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SUBJECT: Iran Finally Passes Targeted Subsidies Bill

REF: 09 RPODUBAI 468; 09 RPODUBAI 503

CLASSIFIED BY: Vinay Chawla, Economic Officer, DOS, IRPO; REASON:
1.4(B), (D)

[¶1.](#) (SBU) SUMMARY: On January 5, the Majlis passed the Ahmadinejad administration's Targeted Subsidies Plan (TSP), with the Guardian Council approving it on January 13 and the President signing it into law on January 24. The bill stipulates that subsidies be removed and prices on staple goods, fuel sources and utilities be liberalized over a five-year period. Its passage ends a protracted debate between the Majlis and Ahmadinejad that centered over who would control and disburse the monies saved by eliminating subsidies, with the eventual compromise that the executive branch will directly determine how to distribute the savings, with required reporting on spending to a Majlis audit committee. While the administration can claim a legislative victory, it must now deal with widespread public concern over a spike in inflation as a result of the legislation, in addition to anxiety over implementation of targeted cash payments. END SUMMARY.

THE HISTORY

[¶2.](#) (SBU) President Ahmadinejad originally submitted a TSP as part of a bill in early 2009 but the Majlis refused to act on it, the conventional wisdom being that it did not want to give Ahmadinejad new sources of money to disburse before the June 2009 Presidential election (reftel A). The bill went to a Majlis committee and re-emerged on the legislative agenda in October 2009. Following the Guardian Council's rejection of the first version of the TSP December 12, the Majlis passed a revised version January 5 that contained a key compromise that settled a dispute over control of subsidy savings. The Guardian Council ratified the new version January 13, and the Majlis formally endorsed and forwarded it to President Ahmadinejad January 16. Ahmadinejad officially enacted the TSP on January 24.

[¶3.](#) (C) The first part of the plan authorizes the government to set a new pricing mechanism that will lead to fully liberalized prices over five years for many staple goods, fuel sources and services that are now provided at a subsidized cost (reftel A). These staple goods and services include sugar, rice and bread; fuel sources include gasoline; gas and gasoil; utilities include electricity and water. (NOTE: Due to fluctuating energy prices, estimates of the cost of Iran's subsidy program vary but most analysts agree that Iran spends between USD 80 to 100 billion a year on subsidies, approximately 30 percent of the country's annual budget and 11 percent of GDP. Energy subsidies alone account for approximately 80 percent of the subsidies. END NOTE.)

MAJLIS FOLDS

[¶4.](#) (C) For months President Ahmadinejad and the Majlis wrangled over who would control disbursement of subsidy savings. Originally, MPs insisted that all subsidy savings go into the national treasury

and government requests for funds come through the annual budget process (reftel B). After Ahmadinejad (on more than one occasion) threatened to pull the legislation unless his government had full control of the funds, the Majlis agreed to a compromise that seems to largely favor the President. The revised plan establishes a new government organization 'The Targeted Subsidies Organization' (as Ahmadinejad had originally stipulated) to administer the subsidy savings with "oversight" from the Majlis. A Japanese diplomat who recently served in Iran and follows its economy closely said he was surprised by the Majlis' concession, asking rhetorically "Who in the Majlis thinks the 'current administration is 'capable' of taking charge of such a vast scheme?"

15. (C) The Majlis did include a provision in the legislation requiring the new subsidy savings disbursement organization present a report every six months to a Majlis audit organization. Additionally, MPs stipulated in the legislation that exactly half of the subsidy savings be distributed to all Iranians and the remaining half be spent on infrastructure, business loans/grants, and grants to individual provinces. As the law is now written the executive branch has the authority to allocate and distribute cash payments to poorer Iranians and individual businesses.

NEW LAW, NEW PROBLEMS

16. (C) An increasing amount of public concern over the new TSP has focused on its expected inflationary effects, especially as it relates to utilities. Reformist press sources have reported that the head of the Tehran Water and Sewage Authority predicted the

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cost of water bills will increase 21 percent after the start of the new Iranian calendar year (March 21). Some websites reported the total increase would be closer to 400 percent, with electricity also expected to double or triple. With respect to inflation in other sectors, state semi-official news agency ILNA published January 12 a poll of a 100 private investors in which all participants concurred that implementing the plan "will result in high inflation, reduced exports, and decreased competitiveness among domestic producers." In a separate report, ILNA reported January 13 that the semi-official 'House of Workers' labor organization warned "about the inflationary effects of the planned removal of subsidies." A labor activist predicted the TSP will lead to major inflation, layoffs, and "we believe this will spark huge labor actions, in somewhere between three months to a year." A member of the Tehran Chamber of Commerce, predicted higher inflation attributable to the TSP may appear as early as the month of Bahman (January 21 - February 21)."

17. (C) Central Bank of Iran (CBI) Governor Mahmoud Bahmani has also acknowledged the prospect of higher inflation after earlier predicting Iran's inflation rate would drop into the single digits. Radio Farda quoted him January 19 as saying, "implementing the subsidy bill will definitely lead to increases in prices and inflation. When the Central Bank promised to lower inflation and make it one-digit it was in view of the economic conditions of last year, but if the subsidies are removed, CBI will not be able to work a miracle and reduce the inflation rate." Bahmani's contradictory comments reflect those of other officials who are trying to respond to growing public discord in the days since the TSP was passed.

18. (C) Questions on who will receive subsidy payments and how much they will receive have been met with contradictory or no response from various government officials. A household economic survey conducted last year by the Statistical Center of Iran (SCI) clustering Iran's population into ten economic groups formed the basis for determining who would qualify for cash subsidies when the legislation was first written. In terms of the number of people who will receive a cash payment though and how many are in each decile, the legislation left it to the government to determine. Since the TSP's ratification, government answers in the press have swung daily between 50, 70, and 100 percent of the population. The SCI website that citizens can use to update their survey data has been inaccessible due to a "high volume of traffic on the site," underscoring lack of government preparation. BBC Farsi reported

that more than 10 million Iranians did not complete the survey last year, many because they feared the supposed cash payment program was really a ruse to collect taxes.

I CAN'T HEAR YOU

¶9. (C) President Ahmadinejad has sought to defuse growing public anxiety over any negative repercussions of the plan. In a recent speech where he sought to address concerns over inflation he said that "I guarantee that within three years, there will be no poor or unemployed person in Iran once this law is put into practice." When asked by one reporter January 24 about the contradictory numbers that the government issued with regard to who qualifies for cash payments, Ahmadinejad responded, "No contradictory comments were made in this regard on the part of the officials. They might have made different comments, but there are no contradictions on the issue of targeting subsidies. Everything is clear and transparent."

SMELLING BLOOD

¶10. (C) Political and government factions concerned with their own interests have attempted to capitalize on the President's 'out-of-touch' response by escalating concerns the government's economic management. In addition to semi-government, technocratic organizations that have questioned liberalizing prices before liberalizing other parts of the economy, political elites have also joined the fray. Reformist daily newspaper Etemad analyzed Majlis Speaker Ali Larijani's surprisingly harsh comments in a January 20 article. According to the article, "the strong criticism leveled by Larijani against the government include his criticism of growth in liquidity and inflation and the decrease in investment, gross domestic production and per capita income from 2005 to 2009." In a January 17 editorial about the TSP, conservative newspaper Jomhuri-e Eslami described "honesty as the master key" and one that is "the missing link which officials ignore." In an apparent shot at Ahmadinejad, the editorial goes on to say, the TSP "has been

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depicted over-optimistically as a miraculous reform scheme that will present a bright and dreamlike future for all people and will root out poverty...instead of elaborating on the problems that this plan will cause for the people." Editorials published in other media outlets representing different political factions have made similar comments since the bill was ratified.

¶11. (C) Given the growing political risk of implementing such a program, IRPO contacts seem somewhat surprised by Ahmadinejad's strong charge forward, though they do point to his ideological bent as the most likely driver, along with his desire to control new revenue streams. One pro-market Iranian economist warned that while implementing the TSP provides a unique opportunity made possible "by a populist administration courageous enough to raise prices to market levels, but which also happens to enjoy the credibility among the poor," the government's plans are "highly flawed and will cause a backlash...and the mixing with other grievances could be serious." He went on to say, "Getting more revenues does not seem right given the potentially high political price and I am skeptical full pricing will occur." Another economist who has worked in Iran and follows Iran's economy closely believed the government is pressing forward in spite of the warnings because Ahmadinejad is confident that by giving out cash to the population, the discontent will be eased. According to our contact, Ahmadinejad additionally perceives the TSP as "his brainchild" and has faith that "he is doing the right thing" based on the relatively tepid protests against the price hikes on gasoline introduced in 2007. In terms of implementation, our contact argued that given the complexity of the reform, the government will continue to pursue a "trial-and-error" approach. Indeed, a January 24 admission by the Commerce Ministry spokesperson that it is stockpiling staple goods in the event that price liberalization causes prices to skyrocket only underscores how little the government really understands what will happen when new prices are announced.

¶12. (C) COMMENT: President Khatami tried to push through subsidy

reform and couldn't do so, and it does seem ironic that the most important pro-market legislation in revolutionary Iran was passed under the Ahmadinejad administration. How much the TSP will truly liberalize the economy and improve the economic standing of Iranians in the long-term will be determined through its implementation. The early indications are that much like the country's foreign policy, government action on the TSP seems to move in one direction and then is contradicted by a move in another. What is consistent is Ahmadinejad's populist messaging in defense of whatever action the government takes. The IRIG seems ill-prepared to respond to public fears and criticism or is intent on implementing the TSP in a way that will have very negative effects on the economy. In such a scenario, it may be forced to backtrack on some of its price liberalization policies. The fiscal implication will be a pull back on cash payments as well, a move that could increase discontent with the IRIG. END COMMENT.

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